

Wacom Co., Ltd.

6727

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■ Summary

Is steadily implementing the medium-term business plan with a sense of speed and taking on the challenge of rebuilding profitability of the Branded Business

Wacom Co., Ltd. <6727> (hereafter, also “the Company”) is the world’s leading manufacturer of pen tablets. Its two business segments are the Branded Business, selling its own-brand pen tablet products, and the Technology Solution Business, which consists of the OEM supply of digital pen and tablet components to manufacturers of finished products, including tablets and notebook PCs.

1. In the 1H FY3/20 results, sales and profits increased due to the growth of the Technology Solution Business

In the Company’s 1H FY3/20 results, sales and profits increased, with net sales of ¥46,932mn (up 1.4% year-on-year (YoY)) and operating profit of ¥3,010mn (up 10.1%). Compared to the initial forecasts also, both net sales and operating profit were above forecast. Looking at the breakdown by business segment, the Branded Business continued to struggle, but this was covered by the growth in earnings in the Technology Solution Business, which enabled overall sales and profits to increase YoY and the initial forecasts to be achieved. The Company’s most pressing issue at the current time is recovering the profitability of the Branded Business, and at FISCO, we think that the delay in achieving this effectively rules out evaluating the results with a perfect 100% score.

2. Three issues have arisen toward recovering the profitability of the Branded Business, and is aiming to resolve them by steadily implementing the medium-term business plan

In May 2018, the Company announced Wacom Chapter 2, its four-year medium-term business plan, and it is currently implementing it. As previously stated, there has been a delay in recovering the profitability of the Branded Business, and by the end of the 1H FY3/20, the following three issues had arisen; 1) reforming the product lineup, 2) strengthening internal structures, and 3) strengthening market creation. However, these are aspects included in the targets of the three Company-wide strategies set out in the medium-term business plan, of 1) Technology Leadership, 2) Island & Ocean, and 3) Extreme Focus, so it has already started to address them. The point to focus on going forward will be the sense of speed in resolving these issues, and clarifying within the current 2H the specific path to catch up in the two-year period of the second half of the medium-term business plan will be vital. At FISCO, we think that this is the most important point to focus on, rather than on the results’ numerical values.

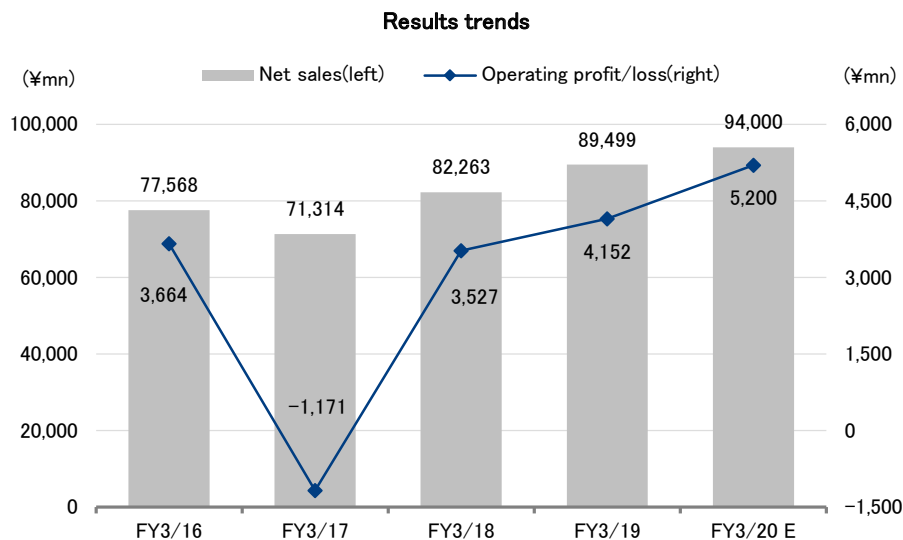
3. For the FY3/20 full year, the key will be the end-of-year peak-sales period in the Branded Business, and the focus will be on the sense of speed in resolving the issues

For the FY3/20 full year, the Company is forecasting net sales of ¥94,000mn (up 5.0% YoY) and operating profit of ¥5,200mn (up 25.2%). These are earnings levels that are fully achievable based on the rates of progress up to the 1H, but at FISCO, we do not think we can necessarily be optimistic. In the 2H, the plan is for the trends in the business segment to change direction by 180 degrees compared to in the 1H and for earnings in the Branded Business to grow. In the background to this plan is the presence of the end-of-year peak-sales period. But when considering the struggles in the 1H and their causes, we cannot necessarily be optimistic. As stated above, the Company is working on resolving these issues toward recovering the profitability of the Branded Business, and we shall be paying attention to whether it achieves steady progress for this.

Summary

Key Points

- The key to recovering the profitability of the Branded Business is to steadily implement the basic strategies set in the medium-term business plan
- Is rebuilding the product lineup from the perspective of “user first”
- Pay attention to new value proposition from “Technology Leadership”



Source: Prepared by FISCO from the Company's financial results

Results trends

In the 1H FY3/20 results, sales and profits increased. No change to a structure in which the sluggish performance of the Branded Business is covered by the performance of the Technology Solution Business.

1. 1H FY3/20 results

In the Company's 1H FY3/20 results, sales and profits increased, with net sales of ¥46,932mn (up 1.4% YoY), operating profit of ¥3,010mn (up 10.1%), ordinary profit of ¥2,548mn (down 12.5%), and profit attributable to owners of parent of ¥2,208mn (up 11.8%).

Ordinary profit decreased YoY due to the recording in the current 1H of foreign exchange losses of ¥500mn in non-operating expenses. Foreign exchange gains of ¥152mn was recorded in the same period in the previous fiscal year. In extraordinary profit-loss, compared to an extraordinary loss of ¥144mn (Loss on retirement of non-current assets) recorded in the same period in the previous fiscal year, there were no especially large items in the current 1H, so a YoY increase in profit attributable to owners of parent was secured.

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Results trends

1H FY3/20 results

(¥mn)

	FY3/19			1H forecast	YoY	FY3/20		vs. forecast
	1H results	2H results	Full year results			1H results	YoY	
Net sales	46,263	43,235	89,499	44,950	-2.8%	46,932	1.4%	4.4%
Operating profit	2,734	1,418	4,152	1,610	-41.1%	3,010	10.1%	86.9%
Operating Margin	5.9%	3.3%	4.6%	3.6%	-	6.4%	-	-
Ordinary profit	2,912	1,237	4,149	1,596	-45.2%	2,548	-12.5%	59.7%
Profit attributable to owners of parent	1,975	1,876	3,851	1,094	-44.6%	2,208	11.8%	101.8%

Source: Prepared by FISCO from the Company's financial results

The details are provided in the sections on the detailed trends of each business segment, but in the current 1H, earnings steadily grew in the Technology Solution Business and a structure continued in which this compensated for the slump of the Branded Business. The Company has positioned strengthening the business structure and recovering the profitability of the Branded Business as its most important management issue, and from this perspective, the fact that this structure has remained unchanged in the current 1H results can not be a happy one.

Details by business segment

(¥mn)

		FY3/19		FY3/20	
		1H results	Full year results	1H results	
				results	YoY
Net sales	Branded Business	20,661	45,443	19,329	-6.4%
	Technology Solution Business	25,602	44,056	27,603	7.8%
	Subtotal	46,263	89,499	46,932	1.4%
Operating profit	Branded Business	532	1,822	-170	-
	Technology Solution Business	4,572	6,659	5,105	11.7%
	Subtotal	5,104	8,481	4,935	-3.3%
	Adjustment amount	-2,370	-4,329	-1,925	-
	Operating profit total	2,734	4,152	3,010	10.1%

Source: Prepared by FISCO from the Company's financial results

On the other hand, there are also points on which the Company can be positively evaluated. One specific example is the progress made in costs controls, particularly in reducing SG&A expenses. The Company has set "the optimization of SG&A expenses" as a slogan and in this sense, it is controlling costs not simply by trying to haphazardly reduce costs, but by determining where they should be used and firmly allocating funds into areas in which they should be invested, while also associating expenses with factors such as sales trends. In the current 1H, the total amount of SG&A expenses declined 6.1% (¥798mn) YoY to ¥12,196mn, and the Company succeeded in reducing the SG&A expenses ratio (the ratio of SG&A expenses to net sales) to 26.0%, which is a record low for a 1H. But on the other hand, R&D expenses, which are essential for growth, increased 13.1% (¥239mn) YoY to ¥2,065mn.

Also, this was achieved even in the situation of the continued struggles of the Branded Business, and the Company can be highly evaluated on the point that net sales are steadily growing in the Displays field, while these products are becoming the mainstream of consumer needs. At FISCO, we think that this expresses the fact that the Company's competitiveness and brand power in the pen tablet market remain as high today as in the past.

Results trends

Breakdown of SG&A expenses

	1H FY3/19	1H FY3/20	YoY	
			Change	% change
Personnel expenses	4,801	4,424	-376	-7.8%
R&D expenses	1,826	2,065	239	13.1%
Sales promotion and advertising expenses	1,348	1,235	-114	-8.4%
Outsourcing expenses	990	820	-171	-17.2%
Depreciation	601	492	-109	-18.2%
Other	3,427	3,161	-267	-7.8%
SG&A expenses total	12,994	12,196	-798	-6.1%
SG&A expenses ratio	28.1%	26.0%	-	-2.1%

Source: Prepared by FISCO from the Company's results briefing materials

In the Branded Business, while Displays is performing strongly, every other product category is noticeably struggling. Recorded a segment loss from the effects of the strong yen and tariffs for China.

2. Trends in the Branded Business

In the Branded Business in 1H FY3/20, net sales were ¥19,329mn (down 6.4% YoY) and the segment loss was ¥170mn (compared to segment profit of ¥532mn in the same period in the previous fiscal year).

Details of Branded Business Results

	FY3/19		FY3/20	
	1H results	Full year results	1H results	YoY
Branded Business	20,661	45,443	19,329	-6.4%
Creative Business	16,982	37,895	16,684	-1.8%
Pen tablets	9,288	20,883	8,090	-12.9%
Displays	6,318	14,410	8,212	30.0%
Mobiles	1,376	2,602	382	-72.2%
Consumer Business	1,180	2,354	691	-41.4%
Business Solution	2,499	5,194	1,954	-21.8%
Segment profit	532	1,822	-170	-
Ratio of segment profit to net sales	2.6%	4.0%	-0.9%	-

Source: Prepared by FISCO from the Company's financial results

In the core Creative Business, sales decreased 1.8% YoY to ¥16,684mn. Looking at the breakdown by product category, they increased 30.0% to ¥8,212mn in Displays, but they decreased 12.9% to ¥8,090mn in Pen tablets and 72.2% to ¥382mn in Mobiles, so there were contrasting developments between the product categories. In particular, in the percentages of total sales, Displays exceeded Pen tablets, which at FISCO we consider to be extremely significant in terms of symbolizing the change in the mainstream of consumer needs.

In Displays, sales increased as the 16-inch, entry-level model, which was announced in January 2019, contributed over the full fiscal period, and also as sales steadily grew of the 22-inch series launched in July.

Results trends

In Pen tablets, sales slowed down because three years have passed since the launch of the models for professionals. Sales also declined of the medium- and low-priced models due to changes in the competitive environment. In terms of these “changes in the competitive” environment, there are two major developments; first is the intensification of competition with the low-priced products of other companies, and second is the shift of demand away from Pen tablets that are like writing boards (which is why they are sometimes referred to as “board tablets”) to Displays in which users can write or draw directly onto an LCD screen for data entry. At FISCO, we estimate that the impact of the second development has been larger.

In Mobiles (centered on professional users), the existing products have entered the second halves of their product life cycles, and this is the direct cause of the significant decrease in sales. On the other hand, it is possible that new opportunities will be created for professional-users by the major changes in the communication environment, centered on the next-generation 5G technology. Based on this point, it is considered that the focus is being shifted toward rebuilding the product strategy, so the Company is intentionally controlling the way of new product launches, which caused the extent of the sales decline to grow.

In the Consumer Business, net sales decreased 41.4% YoY to ¥691mn. A new Windows Ink-compliant stylus pen that was jointly developed with Microsoft was released in June, but sales continued to trend sluggishly.

In Business Solution, net sales decreased 21.8% YoY to ¥1,954mn. In the previous fiscal period, the Company acquired a large-scale project of LCD sign tablet for financial institutions, which drove the major increase in sales in the United States. But in this fiscal period, due to the effects of factors including market trends and changes to the competitive environment, sales declined in general, not only in the United States but also in Europe and Asia, and these declines could not be completely absorbed by the higher sales in Japan.

In profits, the previous segment profit became a segment loss. In the current 1H, the United States implemented additional tariffs against China, and the Company’s products that are produced in China were directly affected by this, with the tax-effect amount reaching approximately ¥0.4bn. Also, in exchange rates, the yen strengthened against the euro and Asian currencies, with the total amount from the effects of this strengthening reaching around ¥0.4bn. This decrease in profits of approximately ¥0.8bn due to these factors caused the segment loss.

In the Technology Solution Business, sales exceeded the forecast and also grew YoY due to the early realization of demand for smartphones.

Sales of tablet and notebook PCs were also steady.

3. Trends in the Technology Solution Business

In the Technology Solution Business in 1H FY3/20, sales and profits increased, with net sales of ¥27,603mn (up 7.8% YoY) and segment profit of ¥5,105mn (up 11.7%).

Results trends

Details of Technology Solution Business Results

	FY3/19		FY3/20		(¥mn)
	1H results	Full year results	1H results	YoY	
Technology Solution Business	25,602	44,056	27,603	7.8%	
For smartphones	11,758	18,265	13,624	15.9%	
For tablets and notebook PCs	13,844	25,791	13,979	1.0%	
Segment profit	4,572	6,659	5,105	11.7%	
Ratio of segment profit to net sales	17.9%	15.1%	18.5%	-	

Source: Prepared by FISCO from the Company's financial results

Net sales for smartphones increased 15.9% YoY to ¥13,624mn. The pen sensor system for smartphones is for the products of Samsung Electronics of South Korea. In the same period in the previous fiscal year, it was shipped for the Galaxy Note 8 and the Galaxy Note 9, but in the current 1H, the shipments shifted to for the Galaxy Note 9 and the Galaxy Note 10. Some shipments for the Galaxy Note 10 were realized earlier than was initially scheduled, in the July-to-September period rather than in the initially scheduled Q3 (October-to-December) period, which was the major reason why sales were higher than forecast as well.

Net sales for tablet and notebook PCs increased 1.0% YoY to ¥13,979mn. In the macro environment, the number of global shipments of tablets is trending downward. In this situation, the Company secures sales increase as a result of the progress made in penetration of the Company's pen sensor system driven by Active ES (AES) technology, which is highly regarded by PC manufacturers.

In profits, alongside the steady rise in net sales, segment profit grew, increasing 11.7% YoY to ¥5,105mn. The profit margin was 18.5%, improving by 0.6%points from 17.9% in the same period in the previous fiscal year. The Company changed its policy for allocating corporate administrative expenses from FY3/19, so a strict comparison with past results is not possible. However, when converted to the previous standard, it is possible that the profit margin would have exceeded 20%, which would have been a new record high for a fiscal half year.

■ Progress on the medium- to long-term strategy and points to pay attention for the future

Three issues have arisen in the year and a half since the start of the new structure. All correspond to the basic strategies in the medium-term business plan and can be resolved by steadily implementing this plan

1. The medium-term business plan and issues

In conjunction with the appointment of President & CEO Nobutaka Ide in April 2018, the Company announced Wacom Chapter 2 in April 2018 as its new medium-term business plan (FY3/19 to FY3/22), and it is currently implementing it. Its content is described in detail in our reports dated June 19, 2018, and June 18, 2019, while a summary of its key points is provided below.

To simply state the theme of the medium-term business plan currently being implemented, it is that the Company is aiming for growth by reflecting on its point of origin as a Technology Company. Or in other words, it might be said that “Its own raison d’etre is to continue to have pride as a pioneer of pen input devices.” The pen input device market is in a stage of fully-fledged expansion, and for this reason alone, competition grows fiercer year by year. Wacom Chapter 2 is an action plan so that even in this situation, the Company can realize growth in the medium- to long-term by utilizing to the greatest possible extent the technologies and experience it has accumulated up to the present time. Toward achieving this goal, it has set three Company-wide strategies; 1) Technology Leadership, 2) Island & Ocean, and 3) Extreme Focus (please refer to the previous reports mentioned above for detailed descriptions of these strategies).

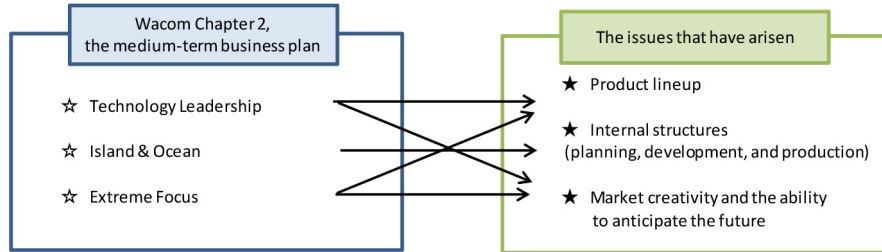
Currently at the end of 1H FY3/20, one year and a half has passed since the start of the present management structure and the medium-term business plan. The contents of the 1H FY3/20 results are as explained above, but the biggest point for them is that there has been no obvious change of “scenery” compared to before the start of the present structure, or in other words, no changes have been seen to the earnings structure in which the struggles of the Branded Business are covered by the performance of the Technology Solution Business.

At FISCO, we think that there are three points in relation to this delay in recovering the earnings of the Branded Business; 1) reviewing and rebuilding the product lineup 2) strengthening internal structures (planning, development, production, etc.) and 3) strengthening market creation and the ability to anticipate the future. Our understanding is that the cause of the Branded Business’ present struggles is the delay in making progress for these three points, and that resolving them is the Company’s most pressing issue.

On the other hand, these three points correspond to the three Company-wide strategies set out in the medium-term business plan that the Company is currently implementing. At FISCO, we think that this is an extremely reassuring point. This is because the Company intends to achieve the targets in the medium-term business plan through resolving these three points (issues) by digging deep through working on the measures in the medium-term business plan. What we think is important is that it is necessary to firmly establish a path in the current 2H in order to catch up with a sense of speed in the two years of the second half of the four-year medium-term business plan. Therefore, it seems that the viewpoint for the current 2H should be placed on this point, rather than on the results’ numerical values.

Progress on the medium- to long-term strategy and points to pay attention for the future

The issues facing Wacom and their resolutions



Source: Prepared by FISCO from the interview

Is rebuilding the product lineup from a “user first” perspective. Intends to differentiate itself through software collaborations and workflow response capabilities

2. Rebuilding the product lineup

In the Creative Business, which is the core of the Branded Business, the Company is developing three product categories, of Pen tablets (“board tablets”), Displays, and Mobiles (please refer the summary of the main products at the end of the report for their respective features).

In the current market environment, due to the lowering of prices of display devices, demand is shifting from the previous main category of Pen tablets to Displays. Compared to Pen tablets, Displays have higher costs as they use liquid crystal panels, so it seems that their average profit margin is lower than Pen tablets. On the other hand, it is considered that the extent of profits is higher for Displays because their average sales unit prices are higher.

The Company remains as strong as in the past in the Display category of pen tablet market. The price band of large-sized products is from around ¥200,000 to ¥400,000 and their users are mainly professionals and high-end amateurs, and the Company appears to be maintaining an overwhelming market share in this category. Conversely, in January 2019, it launched a 16-inch entry-level model with a sales price of around ¥60,000, and its sales are also steadily growing. However, in the entry-level model area, Chinese manufacturers and others are launching products for around ¥40,000, so it will be necessary to pay attention to sales trends in the future.

Pen tablets have a simple structure, so there is a diverse lineup of products on the market, from those intended for professionals to those for beginners. Among them, the Company is maintaining its competitive advantage in the high-end market for professionals, but it has been losing share in the medium- and low-priced band markets that are characterized by price competition.

As input devices, Mobiles products integrate a Display product and a storage device, but this has actually the same usability as general tablet PCs compliant with pen input (ironically, in many cases they have installed the Company’s pen sensor system), so they have competitive relations. For users who focus on input performance, the differences between the two types of products are clear, but for users other than these, it seems that in the choice between the Company’s Mobiles products, which have ultimate input function, and general tablet PCs, they choose the latter.

Progress on the medium- to long-term strategy and points to pay attention for the future

Frankly speaking, on the one hand Displays is a growth category, but on the other hand Pen tablets and Mobiles are mature or declining categories in which it is becoming difficult for the Company to maintain its competitive advantages. It is clear to everyone that the main point going forward will be how far the Company will reform its product lineup in response to this reality.

When selecting the product lineup, the first selection conditions that come to mind are aspects like price competitiveness and production costs, while the Company is also working to rebuilding the lineup with an awareness of users' needs and workflows, or in other words, from the perspective of "user first." It seems that the first users the Company envisages are professionals and high-end amateur users, but workflows are changing greatly in this field. These changes are in various directions, but it can be said what they have in common is "increasing complexity," such as conducting joint work with creators in multiple and remote locations. Collaborations with software are essential to respond to this situation, and the Company has announced its responses in this area in rapid succession. The most recent examples of this are a collaboration with CELSYS, Inc., which is strong in software for production, such as for manga and illustrations (from a press release on October 31, 2019), and also in the same creative field, a collaboration with Adobe, the U.S. software major (from a press release on November 5, 2019).

These Company responses can be considered to be positive in the sense that the risk of falling into low-price competition is small. But on the other hand, it is necessary to be aware that selecting a product lineup that focuses excessively on some users incurs the risk of making the "Extreme Focus" approach too lax and rendering it useless. For example, even if the Company has acquired a 100% share of a sub-segment market, if this market is too small and the investment does not generate profits, it should consider withdrawing from it or reducing its investment. Going forward, it seems that the Company's resolve to make such judgments will be severely called into question.

From the current situation, it is considered that the Company still has some time before it is forced to make such limited judgments. But conversely, from the perspectives of investors and financial market participants, it would be preferable that it presents its guidance at an early stage in terms of how it will change the product lineup from all-around approach to selection and concentration, looking into what its strengths and weaknesses are. To make such guidance, it is considered to be closely related to the progress made for the themes of strengthening the internal structures and market creation, which will be described next.

Expect to utilize its success experiences accumulated in the Technology Solution Business to speed-up the pace of overall reforms

3. Strengthening internal structures

In FY3/17, the Company recorded a significant loss, but it converted this into an opportunity to change the lineup of the management team and formulate the new medium-term business plan. In terms of the major factors behind these developments, it was noted that there were issues to tackle in the internal structures covering the business process as a whole, such as sales, business planning, research and development, production, and other areas. As well as improving this situation, an important theme has been responding to and aligning with the market environment, an external factor.

At FISCO we think that the delay in recovering the earnings of the Branded Business is partially attributable to the progress made in this area which has not been at the expected speed.

Progress on the medium- to long-term strategy and points to pay attention for the future

What is expected to be an important tool here is the Island & Ocean strategy (close collaborations between Island and Ocean). The aim of this is primarily to work on pursuing growth through collaborations between the Branded Business (Island) and the Technology Solution Business (Ocean) in order to accelerate collaborations between all of the functions in these two businesses, which will lead to benefits such as the development of innovation and new business areas, and sustainable growth.

However, at FISCO we think there is one more important perspective for the Island & Ocean strategy. That is to accelerate the reforms and improvements of the Branded Business by applying the Technology Business's success experiences and expertise as "best practices" to the Branded Business.

It would appear that the Company has already implemented personnel exchanges, including redeploying personnel, between the two businesses, but the effects of this have not yet been visible. The reforms and improvements to the internal structures seem delaying, but the details in terms of the causes of this are not clear; namely, whether it is being caused by the personnel aspect such as skills of those engaged in this work, or whether the cause is found in the Company's organizational structure and/or management structure. It is preferable that this issue be resolved at an early stage.

The focus is on whether it can propose to consumers new value for pen input devices and values through "Technology Leadership"

4. Market creation

Looking at the Company's developments in the Branded Business in the last few years, the impression that cannot be wiped away is one of it reacting after the event, and the image is of it being swayed by market changes. However, the pen input device market is a market that the Company pioneered and created, and in which it has been leading. So the honest impression is that something feels wrong when the Company, which remains as strong as before in terms of its technological capabilities and brand power, has fallen into this situation.

So for the earnings of the Company's Branded Business to recover, at FISCO we think that it requires market creation (or "the ability to anticipate the future"). In the event that it cannot be the winner in price competition, one choice is to specialize in the high-end market. But as a leading company in the industry, it seems that the Company intends to target a wide range of markets above a certain level. In the middle- and low-end areas, it is essential to provide value other than price. It is considered necessary to discover potential value that consumers are seeking other than price, or to create and disseminate new "values."

At FISCO, our understanding is that this implication is incorporated into Technology Leadership, which is the basic strategy in the current medium-term business plan. From the user-first perspective described above, measures including reviewing its product lineup and collaborating with software will also lead to the strengthening of market creation. We shall be paying close attention to the progress made in this area in the future.

Business outlook

The full fiscal years forecasts seem to be at fully achievable levels, but it will be necessary to pay close attention to developments in the end-of-year peak-sales period in the Branded Business

● FY3/20 forecast

(1) Overview of the forecast

Following on from the revisions of the 1H results forecasts in August 2019, in October of the same year the Company once again revised the FY3/20 full year forecasts when it announced the 1H results. The latest October forecasts are for net sales of ¥94,000mn (up 5.0% YoY), operating profit of ¥5,200mn (up 25.2%), ordinary profit of ¥4,800mn (up 15.7%), and profit attributable to owners of parent of ¥3,200mn (down 16.9%). The reason for the decline in profit attributable to owners of parent is as a reaction to the fact that in the previous fiscal period, the profit ballooned as the income and other taxes amount was greatly kept down by ¥171mn due to the amounts for the income tax refund and deferred income taxes.

FY3/20 forecast

(¥mn)

	FY3/19			FY3/20						YoY
	1H results	2H results	Full year results	1H results	2H		Full year			
					August forecasts	October forecasts	August forecasts	October forecasts		
Net sales	46,263	43,235	89,499	46,932	50,550	47,068	95,500	94,000	5.0%	
Operating profit	2,734	1,418	4,152	3,010	3,590	2,190	5,200	5,200	25.2%	
Operating margin	5.9%	3.3%	4.6%	6.4%	7.1%	4.7%	5.4%	5.5%	-	
Ordinary profit	2,912	1,237	4,149	2,548	3,574	2,252	5,170	4,800	15.7%	
Profit attributable to owners of parent	1,975	1,876	3,851	2,208	2,346	992	3,440	3,200	-16.9%	

Source: Prepared by FISCO from the Company's financial results

The net sales forecast of ¥94,000mn was reduced by ¥1,500mn from the August forecast of ¥95,500mn. Looking at the breakdown by business segment, in the Branded Business, it was reduced by ¥2,150mn from the August forecast of ¥48,650mn to ¥46,500mn. Conversely, in the Technology Solution Business it was increased by ¥650mn, from ¥46,850mn to ¥47,500mn. These resulted in the reduction of ¥1,500mn on a Company-wide bases.

In profits, the operating profit forecast of ¥5,200mn is unchanged from the August forecast. However, the content of it has been similarly revised from the changes to the net sales forecasts. In the Branded Business, the segment profit forecast has been reduced from ¥3,300mn to ¥2,800mn, but in the Technology Solution Business, it has been increased from ¥6,200mn to ¥6,700mn.

Business outlook

Forecast by business segment

		FY3/19			FY3/20					(¥mn)
		1H results	2H results	Full year results	1H results	2H		Full year		
						October forecasts	YoY	August forecasts	October forecasts	YoY
Net sales	Branded Business	20,661	24,782	45,443	19,329	27,171	9.6%	48,650	46,500	2.3%
	Technology Solution Business	25,602	18,454	44,056	27,603	19,897	7.8%	46,850	47,500	7.8%
	Subtotal	46,263	43,236	89,499	46,932	47,068	8.9%	95,500	94,000	5.0%
Operating profit	Branded Business	532	1,290	1,822	-170	2,970	130.2%	3,300	2,800	53.7%
	Technology Solution Business	4,572	2,087	6,659	5,105	1,595	-23.6%	6,200	6,700	0.6%
	Subtotal	5,104	3,377	8,481	4,935	4,565	35.2%	9,500	9,500	12.0%
	Adjustment amount	-2,370	-1,959	-4,329	-1,925	-2,375	-	-4,300	-4,300	-
Operating profit total		2,734	1,418	4,152	3,010	2,190	54.4%	5,200	5,200	25.2%

Source: Prepared by FISCO from the Company's financial results and results briefing materials

Looking at the breakdown of the 1H and the 2H forecasts, on a Company-wide basis in the 2H, net sales is projected to increase from 1H to ¥47,068mn compared to the 1H. This is because of the large effects in the Branded Business of the growth in sales in Q3 due to the end-of-year peak-sales period, the period in which demand is greatest. In the Branded Business in the current 2H, net sales are forecast to increase by 9.6% YoY and by 40.6% compared to the 1H (¥7,842mn) to ¥27,171mn.

Conversely, in the Technology Solution Business, in the 2H net sales are forecast to increase by 7.8% YoY but to decrease 27.9% (¥7,706mn) compared to the 1H, to ¥19,897mn. This is mainly due to the reaction to the rise in sales in the 1H from demand for Galaxy Note 10 being realized earlier than was initially scheduled.

In the 2H, operating profit will also reflect the above-described trend in net sales. In the Branded Business, it is forecast to increase significantly both YoY and compared to the 1H. In contrast, in the Technology Solution Business, it is forecast to decrease greatly both YoY and compared to the 1H.

At FISCO, we think that while the FY3/20 full year forecasts are at levels that are fully achievable, we cannot necessarily be optimistic. As stated above, in the 2H the trends in the business segments are forecast to change direction by 180 degrees compared to in the 1H. But the Branded Business is a cause for concern. Given its struggles in the 1H, we think that there might also be reasons to be concerned about the end-of-year peak-sales period in the 2H as well. For the Technology Solution Business, the impression seems to be that the 2H forecasts are too severe. But on this point also, net sales for tablet and notebook PCs are forecast to increase significantly, up by more than 25% compared to the result in the same period in the previous fiscal year, and we think we cannot absolutely be certain that this will be easily achieved either.

It is likely that the US-China trade friction and exchange rates, which affected the 1H results, will also continue to be causes of concern. At the current time (the start of November), reports are appearing that the US-China trade friction has started to ease, while for the dollar-yen exchange rate also, which affects sales, the yen is weakening more than was expected for the 2H. However, it would be overly optimistic to think that the US-China trade friction will be instantly resolved after it has reached its current stage, and moreover, for the euro-yen exchange rate, which greatly affects operating profit, the trend toward a slightly stronger yen is continuing. There also remain causes for concern about the economies of Europe, including due to BREXIT and developments in US-EU trade friction, which is reigniting.

Business outlook

There is no doubt that the Company's results have escaped from a temporary sluggish period and are on a recovery track. However, a situation still continues from before in which it is difficult to judge whether this is "the real thing" and whether it will be able to steadily achieve "operating profit of ¥10bn in FY3/22," which is the target set in the medium-term business plan. At FISCO, we think that as well as observing the results' numerical values, for the time being the focus should also be placed on the Company's two businesses especially on the progress made in the qualitative changes in the earnings structure of the Branded Business.

(2) Detailed trends in the Branded Business

In the Branded Business for the current full fiscal year, the forecasts are for net sales of ¥46,500mn (up 2.3% YoY) and segment profit of ¥2,800mn (up 53.7%), so the outlook is for higher sales and profits YoY. But compared to the August forecasts, the forecasts have been reduced by ¥2,150mn for net sales and by ¥500mn for segment profit.

Detailed forecasts for Branded Business

(¥mn)

	FY3/19			FY3/20						
	1H results	2H results	Full year results	1H		2H		Full year		
				Results	YoY	October forecasts	YoY	August forecasts	October forecasts	YoY
Branded Business	20,661	24,782	45,443	19,329	-6.4%	27,171	9.6%	48,650	46,500	2.3%
Creative Business	16,982	20,913	37,895	16,684	-1.8%	23,986	14.7%	41,640	40,670	7.3%
Pen tablets	9,288	11,595	20,883	8,090	-12.9%	11,240	-3.1%	21,430	19,330	-7.4%
Displays	6,318	8,092	14,410	8,212	30.0%	11,168	38.0%	18,540	19,380	34.5%
Mobiles	1,376	1,226	2,602	382	-72.2%	1,578	28.7%	1,670	1,960	-24.7%
Consumer Business	1,180	1,174	2,354	691	-41.4%	759	-35.3%	1,710	1,450	-38.4%
Business Solution	2,499	2,695	5,194	1,954	-21.8%	2,426	-10.0%	5,300	4,380	-15.7%
Segment profit	532	1,290	1,822	-170	-	2,970	130.2%	3,300	2,800	53.7%
Ratio of segment profit to net sales	2.6%	5.2%	4.0%	-0.9%	-	10.9%	-	6.8%	6.0%	-

Source: Prepared by FISCO from the Company's results briefing materials

For the core Creative Business, overall the forecasts are for net sales of ¥40,670mn (up 7.3% YoY). By product category, in Pen tablets sales are projected to be ¥19,330mn (down 7.4%), which is a downward revision of ¥2,100mn from the August forecast. Pen tablets are facing severe competition with the products of other companies in the low- to medium-price-band range, and in addition, demand is shifting from Pen tablets to Displays. It seems that these are the reasons why the Company has changed to a more cautious outlook.

In Displays, sales are forecast to increase significantly to ¥19,380mn (up 34.5% YoY). Sales are strong not only of the 16-inch model launched in January 2019 for entry-level users, but also of the 22-inch model launched in July, and expectations are rising that they will drive the results not only of the Creative Business, but also of the Branded Business as a whole. If results trend as forecast, the outlook is that Displays will overtake Pen tablets to provide the largest percentage of total net sales.

In Mobiles, the forecasts are for net sales of ¥1,960mn (down 24.7%). This is an upward revision of ¥290mn from the August forecast, but as before, the downward trend is continuing. In Mobiles, the Company has launched a new product with only minor changes toward the peak-sales period. But the value redemption points for mainstay professional users may be greatly affected by the changes to the communication environment on the imminent arrival of 5G, so its struggles are continuing as it is considered that it has entered a transition period in the medium term.

Business outlook

For the Consumer Business and Business Solution, the full fiscal year forecasts are for sales of ¥1,450mn (down 38.4% YoY) and ¥4,380mn (down 15.7%), respectively. Both are downward revisions from the August forecasts. In the Consumer Business, it seems that the main reason for the substantial decrease in sales is that for business development, the Company is working on a conversion to shift its focus strategy toward the de facto standard of technology for several eco systems in order to acquire many users. In Business Solution, it would appear that in addition to the overseas market being between demand periods of business pipelines, the factors in the background to the decline in sales are the price competition for terminals and the competition with authentication technologies other than the sign technology in the payments field.

In profits, the segment profit forecast has been reduced by ¥500mn from the August forecast. This is in response to the reduction of net sales. On entering the current fiscal period, as a measure to counter the risk from concentrating production sites, as symbolized by the imposition of additional tariffs against China by the US, the Company has transferred the production lines of some products from China, but it seems that the effects of this have been limited. Currently, a movement toward the easing of the US-China trade friction has started to appear, and should this continue, if tariffs are withdrawn and the tariff rate are reduced, and also if the yen weakens in exchange rates, these would become factors pushing-up profits.

(3) Detailed trends in the Technology Solution Business

In the Technology Solution Business in the current fiscal period, the forecasts are for net sales of ¥47,500mn (up 7.8% YoY) and segment profit of ¥6,700mn (up 0.6%). Compared to the August forecasts, these are upward revisions of ¥650mn for net sales and ¥500mn for segment profit.

Detailed forecasts for Technology Solution Business

(¥mn)

	FY3/19			FY3/20						
	1H results	2H results	Full year results	1H		2H		Full year		
				Results	YoY	October forecasts	YoY	August forecasts	October forecasts	YoY
Technology Solution Business	25,602	18,454	44,056	27,603	7.8%	19,897	7.8%	46,850	47,500	7.8%
For smartphones	11,758	6,507	18,265	13,624	15.9%	4,926	-24.3%	17,900	18,550	1.6%
For tablets and PCs	13,844	11,947	25,791	13,979	1.0%	14,971	25.3%	28,950	28,950	12.2%
Segment profit	4,572	2,087	6,659	5,105	11.7%	1,595	-23.6%	6,200	6,700	0.6%
Ratio of segment profit to net sales	17.9%	11.3%	15.1%	18.5%	-	8.0%	-	13.2%	14.1%	-

Source: Prepared by FISCO from the Company's results briefing materials

Net sales for smartphones are forecast to increase 1.6% YoY to ¥18,550mn, which is an increase of ¥650mn from the August forecast. In 2H, the shipments for the latest Galaxy Note 10 is projected to decrease significantly compared to 1H due to the demand being realized earlier than scheduled in the July-to-September period.

The forecast for sales for tablet and notebook PCs is ¥28,950mn (up 12.2% YoY), which is unchanged from the August forecast. The net sales forecast for the 2H only is ¥14,971mn (up 25.3%). The Company's stance for the Technology Solution Business is that, based on the idea of a "baseline", to incorporate into the forecasts only orders and sales that are certain, so the forecast of an increase of 25.3% in the 2H can be considered to be a reliable one. But in a situation with a sales-increase rate of high 25.3% and the overall market that is contracting YoY, at FISCO we think that the result is hardly expected to exceed the forecast.

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Business outlook

In profits, the full fiscal year segment profit forecast is ¥6,700mn (up 0.6%), which is an upward revision of ¥500mn from the August forecast. This seems to be in conjunction with the increase in sales of the pen sensor system for smartphones. Extracting solely for the 2H, the forecast is for segment profit to decline ¥1,595mn (down 23.6%). The reasons for this include the active investment in R&D toward the next fiscal period and onwards.

Statements of income and key indicators

	FY3/16	FY3/17	FY3/18	FY3/19	FY3/20	
					1H	Full year (E)
Net sales	77,568	71,314	82,263	89,499	46,932	94,000
YoY	4.0%	-8.1%	15.4%	8.8%	1.4%	5.0%
Gross profit	30,736	27,566	31,760	30,478	15,205	-
Gross margin	39.6%	38.7%	38.6%	34.0%	32.4%	-
SG&A expenses	27,072	28,737	28,233	26,296	12,196	-
Ratio of SG&A expenses to net sales	34.9%	40.3%	34.3%	29.4%	26.0%	-
Operating profit	3,664	-1,171	3,527	4,152	3,010	5,200
YoY	-40.3%	-	-	17.7%	10.1%	25.2%
Operating profit margin	4.7%	-1.6%	4.3%	4.6%	6.4%	5.5%
Ordinary profit	3,777	-870	3,585	4,149	2,548	4,800
YoY	-37.7%	-	-	15.7%	-12.5%	15.7%
Profit attributable to owners of parent	2,310	-5,534	2,362	3,851	2,208	3,200
YoY	-33.5%	-	-	63.1%	11.8%	-16.9%
EPS after adjustment for share-split (¥)	14.00	-33.93	14.55	23.71	13.59	19.70
Dividends after adjustment for share-split (¥)	18.00	6.00	6.00	6.00	-	6.50
BPS after adjustment for share-split (¥)	188.22	130.75	139.45	156.54	159.99	-
Capital investment amount	4,862	3,580	1,513	2,380	1,254	2,710
Depreciation	2,004	2,573	2,421	2,324	1,142	2,460
R&D expenses	4,342	4,397	4,385	4,345	2,065	5,100

Source: Prepared by FISCO from the Company's financial results

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Business outlook

Balance sheet

	As of March 31, 2016	As of March 31, 2017	As of March 31, 2018	As of March 31, 2019	(¥mn) As of September 30, 2019
Current assets	37,874	39,500	42,195	42,158	50,244
Cash and deposits	14,365	14,205	19,157	16,763	19,901
Notes and accounts receivable	10,162	10,768	10,738	9,561	15,422
Inventories	10,098	11,665	9,720	13,395	11,131
Other	3,248	2,862	2,580	2,439	3,791
Fixed assets	13,693	10,750	8,714	9,393	10,642
Tangible fixed assets	4,538	4,303	4,301	4,176	5,199
Intangible fixed assets	8,131	4,313	2,951	2,976	2,594
Investments and other assets	1,023	2,134	1,462	2,241	2,849
Total assets	51,567	50,250	50,910	51,551	60,887
Current liabilities	16,479	17,384	16,752	14,653	23,143
Accounts payable	6,103	7,482	7,101	5,376	16,073
Short-term debt	4,000	3,000	3,000	3,000	1,000
Other	6,376	6,902	6,651	6,276	6,070
Fixed liabilities	3,992	11,509	11,489	11,470	11,757
Shareholders' equity	30,770	21,536	22,924	25,828	27,061
Capital	4,203	4,203	4,203	4,203	4,203
Capital surplus	7,513	6,099	6,099	6,101	6,101
Retained earnings	21,629	13,134	14,522	17,399	18,632
Treasury stock	-2,576	-1,900	-1,900	-1,876	-1,876
Total accumulated other comprehensive income	188	-306	-281	-402	-1,074
Share acquisition rights	138	127	25	2	-
Total net assets	31,096	21,357	22,668	25,428	25,987
Total liabilities and net assets	51,567	50,250	50,910	51,551	60,887

Source: Prepared by FISCO from the Company's financial results

Cash flow statement

	FY3/16	FY3/17	FY3/18	FY3/19	(¥mn) 1H FY3/20
Cash flow from operating activities	2,009	122	6,781	1,054	8,342
Cash flow from investing activities	-4,878	-3,480	-767	-2,437	-1,431
Cash flow from financing activities	1,209	3,299	-974	-951	-3,145
Gain or loss on translation of foreign currency cash and deposits	-662	-101	-88	-61	-629
Change in cash and deposits balance	-2,322	-160	4,952	-2,394	3,138
Cash and deposits balance at start of fiscal year	16,687	14,365	14,205	19,157	16,763
Cash and deposits balance at end of fiscal year	14,365	14,205	19,157	16,763	19,901

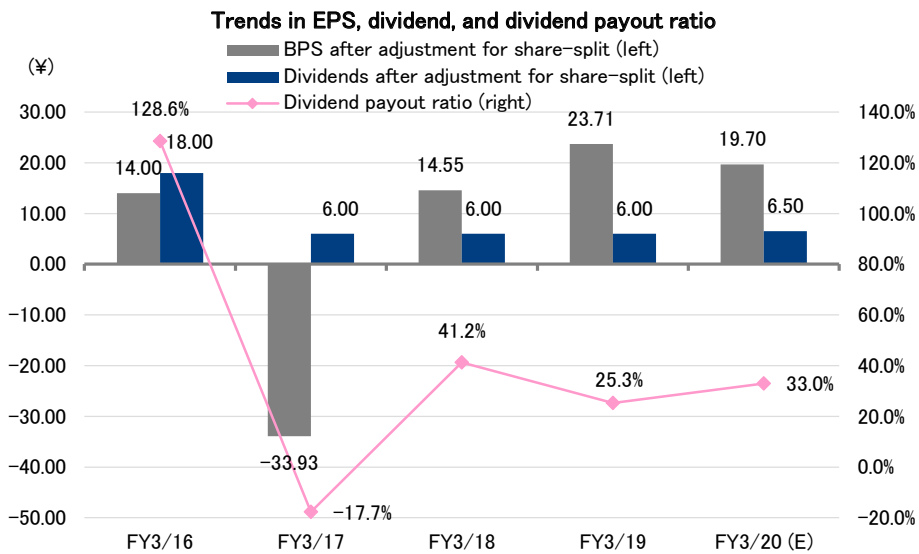
Source: Prepared by FISCO from the Company's financial results

Returns to shareholders

Announced a dividend forecast for FY3/20 of ¥6.5, up ¥0.5 YoY

The Company’s basic policy towards shareholder returns is to pay steady dividends on its profits after considering the amount of funds to be retained for future business development and sound financial base. The Company had previously set a dividend payout ratio of around 40% as the standard for the dividend level, but from FY3/18, it lowered it to around 30%. This was in order to solidify the foundations for growth in the future and was necessary to increase its financial soundness, while in the background is the fact that it has set a target to aim for at the present time of around 60% for the equity ratio (it was 43 % at the end of the current interim fiscal period). Also, the Company only pays dividends once at the end of the fiscal period in consideration of keeping down administrative costs.

For FY3/20, it has announced a dividend forecast of ¥6.5, which is an increase of ¥0.5 YoY. The dividend payout ratio based on the forecast earnings per share (EPS) of ¥19.70 is expected to be 33.0%. In the process of executing Wacom Chapter 2, its medium-term business plan, the Company has significant demand for funds for research and new products development. But on the other hand, it should be confident of its ability to steadily realize profit growth through reforming its cost structure, and at FISCO, we think that this led to its decision to increase the dividend.



Source: Prepared by FISCO from Company materials

■ Company profile

Established in 1983, the Company has grown steadily with technology and now leads the global market of pen tablets for creators

The Company was established in 1983 in Ageo City, Saitama Prefecture. Its name derived from “world” and “computer,” while “WA” includes the meaning of “harmony between people and computers” (“WA” being the Japanese word for harmony, a part of new era REIWA). In 1984, it announced the world’s first cordless pen tablet. In 1987, it launched the SD Series of graphic pen tablets for professionals, which were used by the Walt Disney Company in the United States for film production. Subsequently, it constantly enhanced its products, and in the creative pen tablet market for creators, it has consistently kept leading position on global basis.

In 1991, it entered into the pen sensor components field (currently, the Technology Solution Business). This business involves supply of components and modules, such as the Company’s digital pens, control IC and sensor boards, to the manufacturers of finished products. The business is growing rapidly on the back of the expansions of the markets for tablets and smartphones operable with digital pen.

In the securities market, after listing on the Japan Securities Dealers Association’s JASDAQ market in April 2003, the Company listed on the Tokyo Stock Exchange First Section in December 2005, where it remains today.

■ Overview of the main products

In the mainstay Creative Business, is developing three product categories; Pen tablets, Displays, and Mobiles

In the Branded Business, the Company has a wide lineup of products by target customer and product type. Products are divided into the Creative Business for creative users, the Consumer Business for general consumers, and Business Solution for corporations. In the Creative Business, which is the core business in terms of the sizes of sales and profits, there are three product types: Pen tablets, Displays, and Mobiles. Understanding their differences is important to understanding aspects such as the competitive environment and the products’ future potential.

Pen tablets, which are the most basic type of input device, are comprised of a pen and a tablet (a product like writing board). The same as a mouse or a keyboard, they are used by connecting them to a PC. As they have a simple configuration, they come in a wide lineup, ranging from products for professionals to beginners. They are also called “board tablets.”

Displays are similar to Mobiles in that the tablet screen is a liquid crystal display (LCD). So users can draw intuitively and directly on the screen using a digital pen. However, they are also similar to Pen tablets as they are input devices without an OS or memory device.

Overview of the main products

Mobiles entail integrating a Pen tablet and a tablet PC so that users can draw with a digital pen onto a liquid crystal screen and save the data input into the device as it is. As the user inputs using a digital pen, the method of use is the same as that of a general tablet PC. However, the Company's Mobile products use a dedicated input pen and their performance is overwhelmingly high. Their relations to tablet PCs (whether competitive or not) depend on the levels and needs of the users.

In the Technology Solution Business, the Company provides its pen sensor system to manufacturers of smartphones and tablet and notebook PCs. These manufacturer customers are able to produce products (smartphones, tablets, etc.) with pen input compliant-functions by incorporating the Company's pen sensor system into them.



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